

DEPARTMENT OF STATE REVENUE

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ISSUE

Business Entity Classification.

Authority: IC 6-3-1-10; IC 6-2.1-1-16(27); IC 6-2.1-1-10; IC 6-2.2-3-25; IRC § 7701; 26 CFR §301.7701; *U.S. v. Kintner* 1954 U.S. App.; Tax Policy Directive # 2, 5/92

IC 6-8.1-4-2. Powers of division of audit.

(a) The division of audit may:

...

(3) inspect any books, records, or property of any taxpayer which is relevant to the determination of the taxpayer's tax liabilities ...

[1980]

IRC 7701. Definitions.

(a) When used in this title ...

(1) Person – The term "person" shall ... mean and include an individual, a trust, estate, partnership, association, company or corporation.

(2) Partnership and partner – The term "partnership" includes ... joint venture, or other unincorporated organization, through or by means of which any business, ... venture is carried on, and which is not ... a corporation; and the term "partner" includes a member in such a(n) ... organization.

(3) Corporation – The term "corporation" includes associations ...

[1957]

I. GENERAL STATEMENT

Business organizations have a variety of options when deciding the type of entity under which they will interact with customers, taxing authorities, and others. Among those Indiana options are sole proprietorship, partnership, corporation, limited liability company, limited liability partnership, and limited partnership.

Each of these entities have certain characteristics which confirm their validity. These characteristics are defined in the Indiana Code at Title 23, "Business and Other Associations", and are further amplified in State and Federal litigation.

II. ENTITY DETERMINATION – FEDERAL

A. Periods Beginning Prior to January 1, 1997.

Entity classification was defined by Internal Revenue Code (IRC) Section 7701, "Definitions", and former 26 Code of Federal Regulations (CFR) Section 301.7701. The Internal Revenue Service (IRS) under former 26 CFR § 301.7701-2 evaluated an "association" [FN 1] and determined that it acted as a corporation if it possessed at least three of the following four characteristics: [FN 2]

1. Continuity of life.
(The corporation survives the death of any shareholder)
2. Centralization of management.
(Corporate shareholders generally do not "manage" the corporation)
3. Corporate debt limited to corporate assets.
(Corporate shareholders generally are not liable for debts of the corporation)
4. Free transfer of interests.
(Corporate shareholder may acquire and dispose of shares at will)

B. Periods Beginning on or After January 1, 1997.

Entity classification is defined by IRC § 7701, and amended 26 CFR 301.7701.

Federal "Check-the-Box" Election – Generally an entity that is not a corporation under the laws of any state [FN 3] may elect [FN 4] its entity classification for federal tax purposes under the following conditions:

1. An entity with **two or more members** (If no election, a partnership)
 - a. a corporation
 - b. a partnership
2. An entity with only **one member** (If no election, a disregarded entity)
 - a. a corporation
 - b. disregarded entity

A disregarded entity is an entity whose income, expenses, assets, and liabilities are included with those of its owner and reported in single unsegregated amounts on the owner's federal income tax return. The disregarded entity ceases to exist for federal income tax purposes. “[I]f the entity is disregarded, its activities are treated ... as a ... branch, or division of the owner.” [26 CFR § 301.7701-2(a)]

III. ENTITY DETERMINATION – INDIANA

A. Gross Income Tax. (IC 6-2.1)

1. Limited Liability Company [FN 5] (LLC)

a) Single Member Limited Liability Company (SMLLC) – A SMLLC that elects to be, or by default is, treated under 26 CFR § 301.7701-3 as a disregarded entity for federal income tax purposes, is referenced at IC 6-2.1-1-16(27). [FN 6] A SMLLC that is designated as a federal disregarded entity is exempt from the tax. When the receipts of a SMLLC are combined with those of its owner, such receipts are subject to tax. [FN 7]

b) LLC Treated as a Partnership – A LLC that elects to be, or by default is, treated under 26 CFR § 301.7701-3 as a partnership for federal income tax purposes, is referenced at IC 6-2.1-3-25 [FN 8] and its internal reference IC 6-3-1-19 [FN 9]. A LLC that is designated as a federal partnership is exempt from the tax. [FN 10]

2. Other Entities.

a) Publicly Traded Partnership – A partnership that is treated as a corporation for federal income tax purposes under IRC § 7704 [FN 11] is subject to Gross Income Tax. [FN 12]

b) Classification of entities, other than those discussed in this section III.A., are not controlled by their federal income tax treatment.

The Department will however, in the interest of efficient administration, presume that a federal "check-the-box" election accurately reflects the classification that would have resulted from an analysis under Indiana Tax Policy Directive No. 2, issued May 1992, the guidelines of which are discussed in II, A. above. [FN 13] The Department reserves the right to evaluate such entities under former 26 CFR § 301.7701 if a fair representation of a taxpayer's income is in doubt.

B. Adjusted Gross Income Tax (IC 6-3) – Supplemental Adjusted Gross Income Tax (IC 6-3-8) – Financial Institutions Tax (IC 6-5.5).

A federal entity election or default classification is recognized.

C. Sales and Use Tax (IC 6-2.5) – Other Listed Taxes (IC 6-8.1-1-1)

A federal entity election or default classification is not recognized.

[FN 1] "Association". An organization whose objective is to carry on business and to divide the gains therefrom.

[FN 2] C/k/a "The Kintner Regulations" after *United States v. Kintner*, 1954 U.S. App. (216 F.2d 418)

[FN 3] However, the IRS is not bound by the mere formality of state registration.

[FN 4] IRS Form 8832, "Entity Classification Election".

[FN 5] IC 23-18-1-11. "'Limited liability company' or 'domestic limited liability company' means ... "

[FN 6] IC 6-2.1-1-16. "'Taxpayer' means ... (27) limited liability company (other than a limited liability company that has a single member and is disregarded as an entity for federal income tax purposes)".

[FN 7] IC 6-2.1-1-10. "'Receipts' ... means the gross income ... received by ... any limited liability company that is not itself a taxpayer ... "

[FN 8] IC 6-2.1-3-25(a). "'[P]artnership' and 'partner' have the same meaning as those terms are defined in IC 6-3-1-19."

[FN 9] IC 6-3-1-19. "'[P]artnership' includes ... a limited liability company that is treated as a partnership for federal income tax purposes."

[FN 10] IC 6-2.1-3-25(b). "Gross income received by a partnership is exempt from gross income tax."

[FN 11] IRC 7704(b). "[T]he term 'publicly traded partnership' means ... "

[FN 12] IC 6-2.1-3-25(b).

[FN 13] Example: An entity with one or more members that makes a federal election to be taxed as a corporation.